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No. 02-1318

IN THE
Supreme Court of the United States

ZAPATA HERMANOS SUCESORES, S.A., PETITIONER,

v.

HEARTHSIDE BAKING CO. D/B/A MAURICE LENELL COOKY CO., RESPONDENT.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY BRIEF FOR THE PETITIONER

JAVIER H. RUBINSTEIN
Counsel of Record
THOMAS A. LIDBURY
MICHAEL A. SCODRO
WILLIAM HUBBARD
Mayer, Brown, Rowe & Maw
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

Counsel for Petitioner

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REPLY BRIEF FOR THE PETITIONER

Lenell virtually concedes the certworthiness of this case, which it acknowledges to squarely raise each of the questions presented. Lenell devotes the majority of its opposition to arguing the merits while offering nothing to cast doubt on any of the compelling grounds that warrant Supreme Court review.

A.1. Lenell makes a half-hearted attempt to deny that the Seventh Circuit has created an international split of authority over the recoverability of attorneys' fees under Article 74, insinuating (at 17) that there are only a "handful" of decisions outside the U.S. awarding such fees under Article 74. That is flatly wrong. The Petition cited at least seven decisions holding that "fees in general could be recovered under Article 74" (Pet. 10-11), and the brief of Amici Curiae (at 15-17) catalogues over a dozen more decisions reaching the same conclusion.

Even Lenell's own authorities acknowledge that non-U.S. decisions "appear to award a prevailing litigant compensation for attorneys' fees incurred in the course of the dispute, and they do so not on the basis of a 'loser-pays' principle in the tribunal's own domestic law, but rather on the authority of the damages provisions of the CISG itself." Flechtner, 22 NW. J. INT'L L. & BUS 121.[1] See also Lookofsky, 6 VINDOBONA J. INT'L COMM. L. & ARB. 27 (same). Lenell is also poorly positioned to challenge this consistent line of international authority since Lenell fails to cite a *single decision* anywhere in the world that adopts the Seventh Circuit's contrary view.

Apparently unconvinced by its own position, Lenell (at 3) resorts to asking this Court to simply disregard the decisions of foreign courts because "the Supreme Court has no authority over foreign tribunals." Lenell thus invites the Court to repeat

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[1] Lenell claims (at 20) that a recent article by Professor Vanto "agrees that Judge Posner's decision was correct!" Notably, however, Professor Vanto himself is one of the authors of the Brief of Amicus Curiae International Association of Contract and Commercial Managers and the Institute of International Commercial Law of the Pace University School of Law in *support* of Zapata and in urging this Court to grant the petition.

the very error committed by the court of appeals by disregarding the clear command of CISG Article 7, which requires courts to consider the decisions of other signatory nations to foster the legal uniformity for which the CISG was created. Pet. 9. In short, the international conflict created by the court of appeals is undeniable, and the need to address it equally compelling.

2. Lenell also repeatedly mischaracterizes the question presented as whether Article 74 should be construed as a fee-shifting statute where the "loser" automatically pays. But that is *not* what the district court held; it merely ruled that attorneys' fees may be recovered under Article 74 where, as here, those fees qualify as "foreseen consequential damages." Pet. App. 16a. Incredibly, Lenell ignores this foreseeability component of the question presented (and of Article 74) completely. Lenell thus would have the Court believe that reversal would result in attorneys' fees being automatically awarded in every case. That is simply not so.

As the petition makes clear (at 17), Article 74 is *not* a fee-shifting statute. The question here is whether attorneys' fees may be recovered as *damages* when Article 74's foreseeability requirements are met, just like any other form of consequential loss. In this case, that recovery is compelled by the plain language of Article 74 because it is *undisputed* that Zapata's attorneys' fees meet the foreseeability requirements of Article 74. Lenell stipulated to precisely that. Pet. App. 16a.

Article 74 broadly provides for recovery of *all* "loss[es] which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract * * * as a possible consequence of the breach of contract." Pet. App. 36a. It is also undisputed that Article 74 contains no exclusion of attorneys' fees or any other form of loss from its scope. As the Austrian Supreme Court has held, "a claim for damages [under Article 74] is only limited by the foreseeability of the loss for the party in breach." Pet. 15. Accord *Delchi*, 71 F.3d at 1030. As such, the recoverability of *any* loss under Article 74 depends entirely on

its foreseeability. Moreover, as the Second Circuit held in *Delchi*, Article 74 requires placing "the aggrieved party in as good a position as if the other party had properly performed the contract." 71 F.3d at 1029. As the district court below properly held, "that result is assured only by freeing [a] damages recovery from the burden of attorneys' fees." Pet. App. 17a. Lenell does not deny that.

Lenell points (at 13) to the absence of any reference in the CISG legislative history to the recovery of attorneys' fees. That silence, however, fatally undermines Lenell's reading of Article 74 because it confirms that the framers of the CISG never intended to carve out of Article 74 (as the Seventh Circuit now has) an exception precluding the recovery of attorneys' fees as damages regardless of their foreseeability.

3. In the petition, Zapata also demonstrated that the Seventh Circuit disregarded the clear requirements of CISG Article 7. Lenell notably does not contest this. In fact, Lenell never even *attempts* to argue that the Seventh Circuit complied with Article 7. Article 7(1) requires signatory courts to interpret the CISG with regard for "its international character and * * * the need to promote uniformity in its application and the observance of good faith in international trade." Article 7(2) also requires that any questions "not expressly settled" by the CISG "are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law." It is undisputed that the Seventh Circuit did none of these things. It never cited to any CISG decision abroad, and it completely ignored the general principles of the CISG. This was reversible error, particularly because, as the district court held, the general principles of the CISG strongly support the recovery of attorneys' fees in cases such as this to provide the plaintiff with a full recovery. Pet. App. 16a-17a. See also Pet. 18-19; Br. Amicus Curiae 14-18. Lenell does not contend otherwise.

It is also apparent that the Seventh Circuit violated Article 7 by construing Article 74 according to principles of domestic law, *i.e.*, the "American rule" of attorneys' fees. Lenell tries to deny (at 11) that the Seventh Circuit "was construing CISG by using domestic law." But it is obvious that the court of appeals did exactly that by interpreting the meaning of "loss" in Article 74 *solely* on the basis of domestic cases to hold that "'loss' does not include attorneys' fees incurred in the litigation of a suit for breach of contract." Pet. App. 2a. Even Lenell now relies on domestic law when it argues that attorneys' fees should not be recoverable under Article 74 because they are not available under the U.S. version of the UCC. Lenell forgets that the only reason attorneys' fees are not recoverable under the UCC is that the *American rule* forbids their recovery absent express statutory authority, and *disavows* "the need to provide full compensation." *Summit Valley Indus., Inc.* v. *United Bhd. of Carpenters*, 456 U.S. 717, 725 (1982). The American rule thus irreconcilably conflicts with the general principles of the CISG.

Lenell also does not deny that the Seventh Circuit's reliance on domestic law conflicts with decisions of other circuits that properly have refused to apply principles of domestic law to interpret the CISG. See Pet. 13-14. Indeed, as the brief of amici curiae confirms (at 3-5), there is pervasive confusion among the federal courts as to the role that domestic law should play in CISG cases. This case can put that controversy to rest.

4. Lenell tries to defend the Seventh Circuit's reliance on domestic law by arguing that the recoverability of attorneys' fees under Article 74 should be treated as a procedural question left by the CISG to domestic law. But that is plainly wrong. As Lenell concedes, resolution of the question presented here turns upon the meaning of terms *expressly used* in Article 74. Their meaning is necessarily a question of substance that must be governed by the CISG itself. Indeed, Lenell never explains how the meaning of CISG terms could possibly be a procedural question to be governed by 62 different sets of domestic laws. Whether or not attorneys fees are a recoverable form of "loss"

under Article 74, there can only be one answer to that question, and it surely cannot be governed by domestic law.

Lenell's insistence on treating the question presented as procedural also reflects a basic misunderstanding of the distinction between the *automatic* shifting of fees in all cases—a procedural question governed by domestic law—and the recovery of attorneys' fees as *damages* under Article 74 where their foreseeability must be proven on a case-by-case basis— a substantive question governed by the CISG. As amici explain (at 14), this distinction is firmly grounded in the CISG's jurisprudence. For instance, the decision of the German Court of Appeals in Dusseldorf (discussed at Pet. 10) (which Lenell also features, at 17) awarded the plaintiff certain of its attorneys' fees pursuant to domestic procedural law, but ruled that the remaining attorneys' fees, which were not awardable domestically, were recoverable under Article 74 as *damages*.

Lenell's complaint that the recovery of attorneys' fees under Article 74 would produce anomalous results is also easily refuted when one considers that attorneys' fees would only be recoverable as damages. It is hardly anomalous that only a plaintiff (or counter-plaintiff) would be able to recover damages. After all, that is how lawsuits work. Likewise, Lenell's concern that it would be procedurally difficult to award fees as damages because they cannot be assessed until the end of the case is illusory because the question of fees can easily be bifurcated, just as occurred below and is routinely done in fee-shifting cases.

5. In short, Lenell casts no doubt on the compelling need for Supreme Court review. If anything, Lenell confirms the international controversy that has surrounded this case. As amici curiae demonstrate, there is a great need for this Court to clarify the proper methodology for construing the CISG. It is also critically necessary to resolve the meaning of Article 74, which serves as the most important remedial provision in the CISG. As amici explain (at i), the supreme courts of other CISG signatories repeatedly have contributed their guidance to foster a common

understanding of the CISG. The United States stands as a notable exception. This case provides an important opportunity to remedy that silence.[2]

B.1. Lenell ignores the district court's findings of bad faith that supported its sanction of Lenell. Lenell suggests that the district court imposed sanctions merely for "stiffing" a creditor and nothing more. That is sheer nonsense. What the district court found was that Lenell engaged in "extreme bad faith" not only by refusing to pay an indisputable debt, but by then misusing the judicial process to "make it as difficult and expensive as possible for Zapata to receive its money in this litigation." Pet. App. 21a. The court *specifically* found that Lenell carried out its scheme by "dramatically and needlessly expanding the scope of this litigation" and "interposing a host of unwarranted roadblocks" through "late-advanced, convoluted, multifarious and (regrettably) baseless defenses and counterclaims." *Id.* at 20a-22a, 23a, 25a. Lenell concocted dozens of frivolous defenses and counterclaims that Zapata could only refute through prolonged and expensive discovery, claiming that Zapata caused it to pay customer fines that never existed, denying receipt of shipments it actually received, claiming damages for shipments that had nothing to do with Zapata, and claiming late delivery of orders that were never placed. Throughout the litigation, Lenell invented more than 100 of these defenses and counterclaims, thereby (as the district court found) "dragging out what should have been a relatively simple collection case for goods sold and delivered * * * into an enormously time-consuming and expensive lawsuit." *Id.* at 23a. Incredibly, Lenell *never* mentions these findings. The inescapable fact nevertheless remains, though, that the court's findings of pervasive bad faith easily supported its sanction.

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[2] Lenell points to the relative paucity of federal decisions construing the CISG as a reason to deny certiorari. In fact, as the Pace University CISG database (Pet. 7 n.2) confirms, many CISG cases are decided by international arbitration, which typically does not result in published decisions.

2. In the face of nine circuits espousing a rule contrary to that of the Seventh Circuit below, Lenell denies that there is a circuit split over whether federal courts have the inherent power to sanction bad faith conduct that is otherwise sanctionable by statute or rule. It also claims that this question was settled by *Chambers* despite the circuits' wildly varying interpretations of this Court's decision. See Pet. 25. Lenell conveniently avoids the ambiguity in *Chambers* by carefully editing the Court's language. In fact, Lenell misquotes *Chambers* twice in one sentence: Lenell writes that "*Chambers* also teaches that 'when there is bad faith conduct in the course of litigation that could be adequately sanctioned under the Rules [of Civil Procedure or statutes], the court should rely on [them] rather than the inherent power,' for inherent power 'exist[s] to fill in the interstices.' 501 U.S. at 46, 50." Br. in Opp. 25 (alterations in original). Lenell *omits* the critical word "ordinarily" from the quotation, the very source of much of the present confusion in the circuits. Second, this Court did *not* hold that the inherent power doctrine "exist[s] to fill in the interstices." What the Court said was that:

> "We discern no basis for holding that the sanctioning scheme of the statute and the rules displaces the inherent power to impose sanctions for the bad-faith conduct described above. * * * [T]he inherent power extends to a full range of litigation abuses. At the very least, the inherent power must continue to fill in the interstices."

501 U.S. at 46. Read in context, it is clear that *Chambers* presented, but did *not* settle, the question this case now raises.

3. Lenell also claims that the circuits are united in holding that inherent power sanctions may not be imposed unless the court finds that rules and statutes are "not up to the task." Br. in Opp. 26.[3] It cites four cases, two of which the petition cited (at 23-24) as reflecting the minority views of the First and Third

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[3] Lenell wrongly argues (at 26) that the district court could have invoked Rule 11 *sua sponte* to award attorneys' fees; in fact, imposition of *sua sponte* sanctions can *not* include the award of attorneys' fees. See Rule 11(c)(2)(A).

Circuits, see *United States* v. *One 1987 BMW 325*, 985 F.2d at 661; *Montrose Med. Group Sav. Plan* v. *Bulger*, 243 F.3d at 785, and two of which imposed no requirement at all that the rules be "up to the task." See *Mark Indus. Ltd.* v. *Sea Captain's Choice, Inc.*, 50 F.3d 730 (9th Cir. 1995); *Hutchinson* v. *Pfiel*, 208 F.3d 1180 (10th Cir. 2000).

Zapata certainly does not deny the existence of the minority view of the First, Third, and Seventh Circuits. To the contrary, that view forms a basic element of the circuit split described in the Petition. But Lenell is plainly wrong to deny the existence of the majority view adopted by nine circuits that a court *may* impose sanctions under its inherent power regardless of whether a rule or statute would apply to that conduct. See Pet. 23-24. In fact, Lenell's miscitation of these cases is astonishing.

Zapata cannot in the space of this reply brief refute each mischaracterization of the cases that comprise the majority rule. The cases will speak for themselves. A few examples, though, are in order. For instance, Lenell tries to duck *Fink* v. *Gomez*, 239 F.3d 989, 994 (9th Cir. 2001), by falsely arguing that *Fink* did not "hold that a court can resort to its inherent authority without considering whether the Rules are up to the task" and that *Fink* had not even "addressed this issue." Br. in Opp. 29. In fact, the district court in that case imposed sanctions under its inherent power without considering Rule 11 or § 1927. 239 F.3d at 991. On appeal, the appellant specifically argued (as Lenell does) that "the district court erred in basing its decision on inherent authority and declining to consider sanctions available under Rule 11 or 28 U.S.C. § 1927." *Id.* at 994. The Ninth Circuit disagreed: "[i]t is well settled * * * that the district court may, in its informed discretion, rely on inherent power rather than the federal rules or § 1927." *Id.* Thus, the court rejected the very argument that Lenell claims was not even "addressed."

Lenell also falsely claims (at 28) that *RTC* v. *Dabney*, 73 F.3d 262 (10th Cir. 1995), "awarded sanctions under the inherent authority doctrine precisely because it concluded that the

award—an attorney fee award to the court for the time it wasted on a motion—was not allowable under 28 U.S.C. § 1927. Thus, § 1927 was not up to the task and the court needed to rely on its inherent authority." In fact, the district court and Tenth Circuit both held that the conduct *was* sanctionable under § 1927, but nevertheless upheld the entire sanction "under the court's inherent power." *Id.* at 265, 267.

Lenell also ignores the holdings of the remaining cases that comprise the majority view rejected by the Seventh Circuit. For instance, in *Pickholtz,* 284 F.3d at 1377, the Federal Circuit squarely held that "*Chambers* * * * permits, indeed requires, the court to separately consider [a] motion for attorney fees under its inherent power, which is an independent basis for assessing sanctions, one not preempted by Rule 37." Lenell also disregards the Eleventh Circuit's holding in *Thomas* v. *Tenneco Packaging*, 293 F.3d at 1320, that the inherent power "'can be invoked even if procedural rules exist which sanction the same conduct'" (quoting *Chambers*). And in *First Bank of Marietta* v. *Hartford Underwriters Ins. Co.*, 307 F.3d at 510, the appellant argued, just as Lenell does, "that because Rule 11 could have dealt with the questions of sanctions * * * the district court abused its discretion by awarding [appellee] attorney fees based on its inherent powers." The Sixth Circuit disagreed: "Even if there were available sanctions under statutes or various rules in the Federal Rules of Civil Procedure, the Supreme Court in *Chambers* emphasized that the inherent authority of the Court is an independent basis for sanctioning bad faith conduct in litigation." *Id.* at 511. Contrary to Lenell's claim, the court flatly *rejected* the notion that inherent power sanctions may only be imposed where rules are "not up to the task": "[t]his Court has affirmed the imposition of sanctions under the district court's inherent authority where the district court did not expressly consider particular rules of civil procedure." *Id.* at 513. The Sixth Circuit also recognized the circuit split over the meaning of *Chambers* (*id.*)—the very circuit split whose existence Lenell now pretends not to exist.

4. Lenell also tries to explain away the circuit split over whether courts can consider pre-litigation conduct in sanctioning bad faith pursuant to their inherent power. It does so by dodging the issue, recasting it as whether courts can sanction purely pre-litigation conduct. But that is not the question presented. What the Seventh Circuit held was that the district court could not sanction conduct "giving rise to the litigation" even if that conduct was directly related to sanctionable conduct *during* the litigation—which is precisely what the district court found. Pet. App. 7a-8a, 20a-22a, 23a, 25a. On this score, other circuits clearly disagree. For example, Lenell itself cites (at 24) the Eighth Circuit's decision in *Lamb Engineering*, which "adopted the view *promulgated by various circuits* that, in determining whether to award attorney fees based on the litigant's bad faith, '[t]he court may consider conduct both during and prior to the litigation, although the award may not be based solely on the conduct that led to the substantive claim.'" 103 F.3d at 1435

Lenell also claims (at 24) that "*Sussman v. Bank of Israel*, 56 F.3d 450, 459-460 (2d Cir. 1995) (Petition at 26-27) * * * do[es] not address, let alone hold, that pre-litigation misconduct can form the basis for an inherent authority fee award." That again is false. The sanctions in *Sussman* were based largely upon pre-litigation letters written by the sanctioned party. 56 F.3d at 455. The Second Circuit *specifically* held that "[w]hile Rule 11 extends only to papers filed with the court, the court's inherent power is broader and would permit the court to impose sanctions on the basis of related bad-faith conduct prior to the commencement of the litigation." *Id.* at 459 (citing *Chambers*). In short, the circuit splits described in the petition over the limits of the inherent power doctrine and the meaning of *Chambers* are both very real and irreconcilable. The petition should be granted to resolve these important questions once and for all.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

JAVIER H. RUBINSTEIN
Counsel of Record
THOMAS A. LIDBURY
MICHAEL A. SCODRO
WILLIAM A. HUBBARD
Mayer, Brown, Rowe & Maw
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

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